Missionary zeal of a value investor p27

Market monitor Results season reflects narrow earnings pool p25

Property Pool owners thrown in the deep end p29

Fund superstars

View from the top Morningstar’s award winners explain their strategies and outlook for investment markets. Vesna Poljak reports.

Perpetual Investments chief executive Geoff Lloyd confesses he is still scarred by the global financial crisis and to this day “every asset manager who’s running other people’s money feels like we let people down”. Yet Perpetual’s funds were so dominant in 2013 that the wealth company has again taken out the Australian Morningstar Awards.

Perpetual was announced overall Fund Manager of the Year at the annual Morningstar Awards on Friday evening. The top funds in seven categories – based not only on 2013 returns but consistent outperformance over time – were also announced.

Lloyd’s contriteness is not misplaced. This year has already thrown up a cycle’s worth of challenges, and the unique mix of volatile macro conditions and optimism around the outlook for shares will test even the best stockpickers in 2014, making a sound investment strategy even more important.

The interim earnings season has delivered few shocks, but there is a brewing concern – how to reconcile the ASX 200’s share price run with unremarkable earnings growth.

Gian Pandit, co-head of Australian fundamental equities at fellow finalist AMP Capital Investors, calls this out as one of the risks that could unsettle the 15 per cent rally in shares achieved last year. “If we don’t see these earnings coming through, then we will sell off because we’ve had 14 months of a P/E rerate with little to no E coming through,” he said. P denotes price and E earnings.

Pandit likes Seek, REA Group and Ramsay Health Care because they are investing for growth independent of the cycle. He also favours the US earnings theme, domestic construction and the ageing population.

Last year equity managers had an easier time than fixed income managers when shares rose sharply and bond yields rose.

Morningstar research shows 73 per cent of actively managed large-cap Australian share funds, 361 out of 494, outperformed the S&P/ASX 300 Accumulation Index after fees in the 12 months to December 31.

The success rate dropped to 52 per cent over three years and 40 per cent over five years.

For fixed income managers, 31 of the 80 actively managed funds outperformed the UBS Composite Bond Index last year.

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Fund superstars

Lloyd says he is confident of a “modest improvement” in conditions ahead, but pays credit to his team for their performance in even weak market conditions. “The greatest outcome overall is these fantastic unrivalled returns for our clients, and they’re confident returns because at a time we’ve had cycles within cycles.”

Morningstar’s awards are not a reflection of how the league tables stood at the end of 2013: honours are handed out by evaluating performance from what we see as a pretty optimistic outlook for companies and the trade-off between quality, the earnings growth they can achieve and the price of those earnings, he says. They have been well over the long term and you have to have conviction from us that will be the case in future.”

Arnold says Bennelong’s Morningstar award is “a big source of new ideas for us, because we’re so busy we pass on the vast majority. We have generated average annual returns of 2.8 per cent over the past five years, 3.9 per cent points ahead of its benchmark and helped along in recent times by strong performances from the likes of RBA Group, Ramsay Health Care and 21.

“Traditional IPOs are a big source of new ideas, for us because we’re so busy we pass on the vast majority.” Mark Arnold

Domestic equities

Bennelong’s Australia Equity Partners’ Paul Cuddy and Hyperion Asset Management’s Mark Arnold both say one factor has given them confidence to invest in equities: “We are credit specialists, constantly looking for uncovering credit opportunities and taking an active approach to both credit and interest rate risk management,’ says Arnold.

He and his team focus on analysing how proficient a company is in generating returns on equity. Factors like a conservative balance sheet, sound management, efficient capital spending and strong cash generation all go into the mix.

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International equities

Global stocks had a stellar year in 2013, with many global bourses achieving fresh record highs. That backdrop flattered the performance of international equities managers, but it was Goldman Sachs Asset Management’s Wellington Management Company that finished top in the prestigious category.

MFS Investment Management and Arrowstreet Capital were finalists. The S&P 500 posted a return of 22.6 per cent in 2013, recording its best year in 10 years. The MSCI World Index recorded its best return of international equities managers, but many global bourses achieving fresh record highs. That backdrop flattered the performance of international equities managers, but it was Goldman Sachs Asset Management’s Wellington Management Company that finished top in the prestigious category.

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The outlook for listed Australian property is getting interesting again, given the attraction of strong, reliable yields the trusts provide.

Stuart Cartledge, Phoenix

The reporting season is over and the following sectors can take a bow: health; consumer discretionary; materials; banks. Everyone else, it seems, can do better.

The key driver of the season has been the solid performance of margins. Sales forecasts for industrials have been ratcheted down but margins are tipped to hold steady. With low borrowing costs keeping net interest expenses low, margins have lessened the impact of some soft top line growth numbers.

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Outlook statements are still quite cautious despite record low interest rates and an upbeat in business confidence surveys.

For sure, cost cutting has been a major theme again but there have been good growth signs for some cyclical.

According to Deutsche Bank, earnings growth for cyclical has picked up by as much as 12 per cent. A fair chunk was due to cost cutting, but there are signs of an improving revenue environment.

But for all that’s been written about stocks over the past few weeks, Clime’s John Abernethy notes that the index has not lifted since early 2006, while the surge in the market from 2004 to 2007 was driven by resource stocks.

Of the $4.9 billion increase in earnings, 96 per cent comes from four sectors. They also delivered about 8 per cent of the increase in dividends.

“All indices have struggled to recoup the 2007 high. The uplist over the past 15 months has been the result of the solid re-pricing of the financial services sector, particularly the big four banks.

In the past couple of weeks, it has been BHP and Rio that have stock the index,” he says.

The past decade the index has risen by about 60 per cent. It’s always tough for local investors to head offshore but maybe now is the time.

A few years ago the three major industrialised regions of the world, China, Europe and the United States, were slowing at the same time.

That’s not the case any more. And there is a wider range of companies to choose from, in particular IT stocks.

In addition there are three billion potential new consumers in Asia, and hundreds of millions more in Latin America and eastern Europe.

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